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Tax Cuts and Jobs Acts

- Enacted December 2017
- Tax cut on business income
- Review specific rules of the tax cut
- Compare taxation of different business entities
- Opportunity Zones
- Bonus Depreciation
- Meals & Entertainment

Corporate Tax Rate

- **21% Flat rate on C corporation income**
 - Applies to fiscal years commencing after 12/31/17
 - Blended rate for fiscal years that begin prior to, but end after, 12/31/17
 - Former rate was 34% on income up to \$10 Million, and 35% for income in excess of \$10 Million
- **21% on Personal Service Corporations**
- **Corporate AMT repealed**

When to use a C Corporation

- “Double Tax” effect of the C corporation
- Compensation payments to Owners to offset double tax effect
- Lower 21% rate beneficial where business retains cash to reinvest or pay down debt.
- §1202
- Future S corporation election allows for conversion to flow-through entity

Flow-through Entities

- S corporations are flow-through entity so income tax on earnings paid by owners.
- Similarly partnerships, LLCs and sole proprietorships are flow-through entities.

Qualified Business Income Deduction

- Applies to tax years beginning after 12/31/17 through 12/31/25
- 20% deduction for business income
- Legislative goal is to reduce tax rates on business income for non-corporate businesses similar to the tax rate reduction for C corporations.
- Qualified Business Income
 - Excludes investment income (dividends, investment interest, capital gains etc.)
 - Excludes foreign sourced income
 - Excludes specified service businesses and wages paid to employees

What is QBI?

- QBI is net income arising from a trade or business.
- QBI does not include investment income or income from the sale of assets used in a business.
- QBI is determined by the business entity
- Each partner or shareholder calculates its own QBI deduction
- An owner reports the QBI deduction on Form 1040

Independent Contractors

- Wages of an Employee do not qualify as QBI
- Income of a contractor qualifies as QBI
- IRS has long challenged contractor status if workers appears to be common law employees.
- IRS issued proposed regulations that creates presumption that employee who converts to independent contractor without change in type of service to same business is not entitled to QBI deduction

Limitation on QBI Deduction

- QBI deduction may not exceed greater of
 - 50% of W-2 wages for such business
 - 25% of W-2 wages, plus 2.5% of the unadjusted tax basis of qualified property
- W-2 wage limitations do not apply to owner whose taxable income is less than threshold amounts, subject to phase-in
- Threshold amount is taxable income of \$315K (joint) or \$157.5K (single)
- Phase-In range is \$100K (joint) and \$50K (single)

Example of W-2 Wage Limit

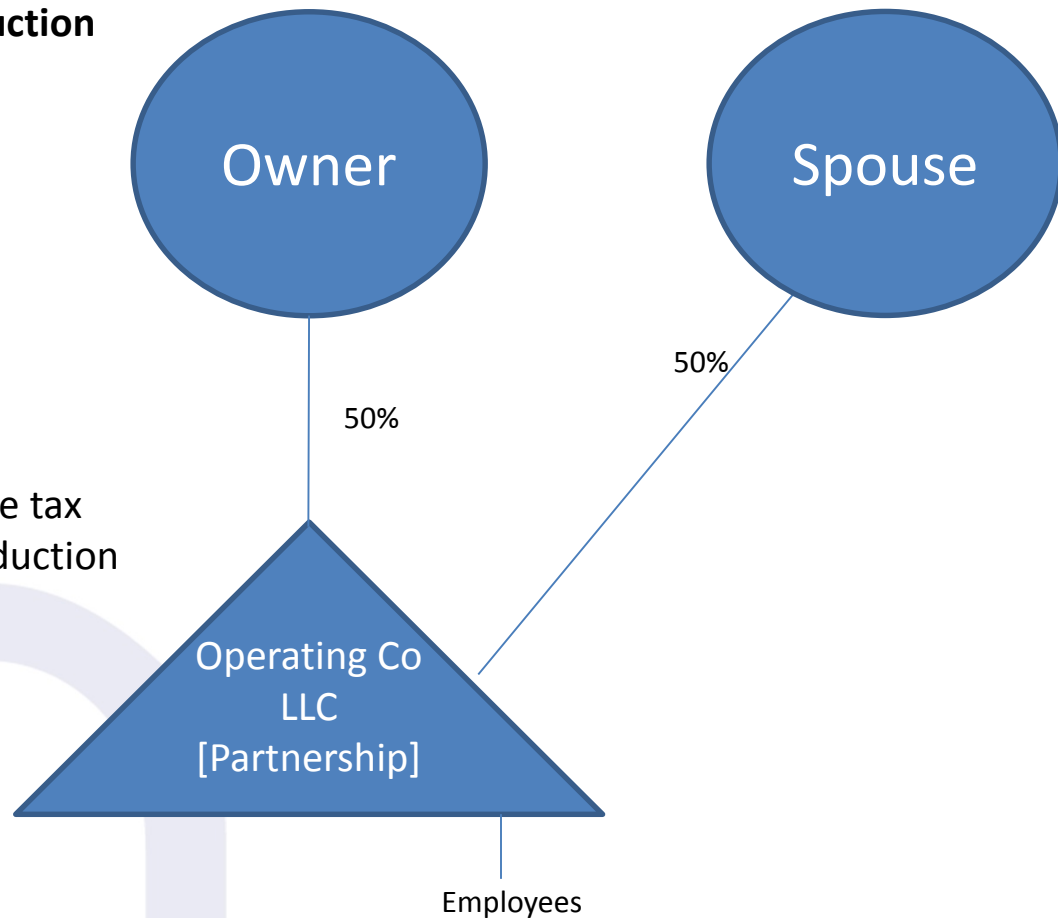
- Sole owner of S corporation has \$1 million of QBI and paid wages to employees of \$300K. The QBI deduction is \$150K (the lesser of 50% of the wages or 20% of the QBI).

Specified service trade or business

- **SSTB not eligible for QBI deduction, unless TI of owner under threshold**
- **SSTB - performance of services in the fields of**
 - **Health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or**
 - **Investing and investment management, trading, or dealing in securities**

Example of 20% QBI deduction

20% QBI deduction
No Net Investment Income tax
Ohio Business Income deduction

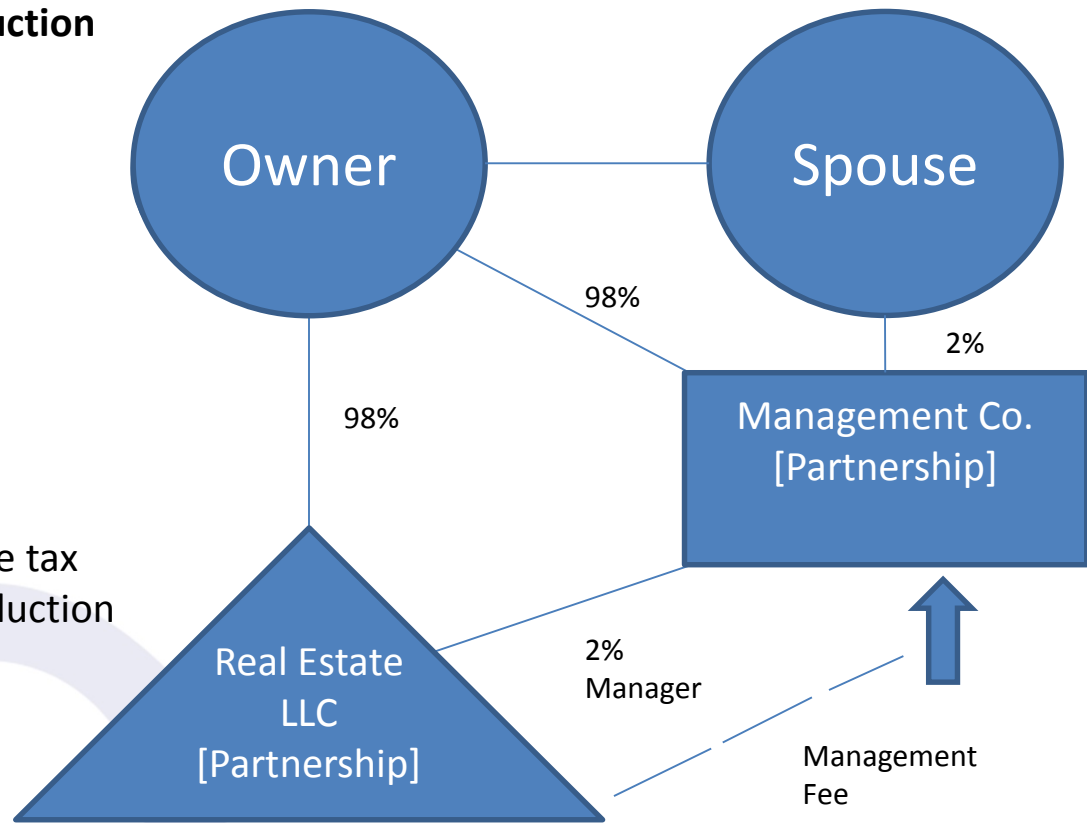


Assumptions:

1. \$1 Million net income of LLC
2. W-2 wages of LLC at least 400,000
3. LLC's business is not Specified Service Business
4. QBI deduction is \$200,000

**Example of 20% QBI deduction
Apartment Building**

20% QBI deduction
No Self-employment tax
No Net Investment Income tax
Ohio Business Income deduction



1. LLC has net income of \$1,000,000
2. LLC owns apartment building @ original cost of \$10 million
3. LLC has no employees
4. QBI deduction limit is \$250,000 (2.5% times \$10 million)
5. QBI deduction is \$200,000 (20% of \$1 million net income)

Operating Cash Flow Distributions

	C Corp	Pass-Through
Corporate Tax	21.0%	--
Dividend Tax	15.8% ¹	--
Individual Tax on Income	--	37.0%
QBI deduction	--	(7.4%) ²
Net Investment Income Tax	3.0% ⁴	-- ³
Ohio income tax	4.0% ⁵	3.0% ⁶
Total	43.8%	32.6%⁷

1. $.79 \times 20\% = 15.8\%$

2. $.37 \times 20\% = 7.4\%$

3. If pass-through owner is active no NII tax

4. $.79 \times 3.8\% = 3.0\%$

5. $.79 \times 5.0\% = 4.0\%$

6. Ohio Business Income Deduction

7. If owner is passive or subject to self-employment tax, the tax rate increases to 36.4%

Reinvest Cash Flow or Pay Down Debt

	C Corp	Flow-Through
Corporate Tax	21%	--
Dividend Tax	--	--
Individual Tax on Income	--	37.0%
QBI deduction	--	(7.4%) ¹
Net investment income tax	--	-- ²
Ohio income tax	--	3% ³
Total	21%	32.6%⁴

1. $.37 \times 20\%$
2. If pass-through owner is active, no Net Investment Income tax
3. Ohio Business Income deduction
4. If owner is passive or subject to self-employed tax, rate increases to 36.4%

Specified Service Business Example

	C Corp	Flow-Through
Corporate Tax	--	--
Dividend Tax	--	--
Individual Tax on Income	37.0% ¹	37.0%
QBI deduction	--	-- ²
FICA & Medicare Tax/Self-Employment Tax	3.8% ³	3.8% ⁴
Ohio income tax	5.0%	3.0%
Total	45.8%	43.8%

1. Assume all cash flow paid to owners as compensation
2. Specified service business excluded from QBI deduction, except if below income thresholds.
3. FICA taxes, including Medicare, applies to wages
4. Assumes all income is subject to self employment tax

Business Sale Proceeds

	C Corp	Flow-Through
Corporate Tax	21.0%	--
Dividend Tax	15.8% ¹	--
Individual Tax on Sale Gain	--	20%/25%/37% ²
QBI deduction	--	--
Net Investment Income Tax	3.0% ³	-- ⁴
Ohio income tax	4.0% ⁵	3% ⁶
Total	43.8%	23%/28%/40%

1. $.79 \times 20\%$
2. 20% capital gains / 25% depreciation recapture real estate/ 37% depreciation recapture personal property
3. $.79 \times 3.8\%$
4. If owner is active, no Net Investment Income tax
5. $.79 \times 5\%$
6. Ohio Business Income Deduction rate

Effective Marginal Rates by Entity

	C Corp	Flow-Through
Operating Cash Flow: Non Service	43.8%	32.6%/36.4%
Reinvest Cash/Pay-down debt	21.0%	32.6%/36.4%
Specified Service Business	45.8%	43.8%
Business Sale Proceeds	43.8%	23%/28%/40%

Bonus Depreciation & §179 Expensing

- **100% expensing for property placed in service after 9/27/17 through 12/31/22; after 12/31/22 reduced expensing percentages**
- **Qualified Property – New or Used**
 - Tangible personal property with recovery period of 20 years or less under MACRS
 - Qualified improvement property (improvements to the interior portions of non-residential property but not structural framework of building)
 - No limit on amount
- **§179 Expensing of tangible personal property (new or used) purchased for use in trade or business**
 - Limited to \$1,000,000 annually – does not sunset.
 - Phase-out begins at \$2.5 Million of qualifying purchases
 - Taxable income limitation on deduction, with carryover for excess

Entertainment Expense (not-deductible) VS. Business Meals (50% deductible)

- **What is “entertainment”?**
 - **Examples: entertaining at night clubs, cocktail lounges, theaters, country clubs, golf and athletic clubs, sporting events, and on hunting, fishing, vacation, and similar trips.**
 - **Entertainment-related meals**
 - **If it is entertainment, then no deduction.**
 - **Entertainment facilities – any property owned or rented for use in entertainment.**
 - **Club membership dues.**
 - **Tickets for sporting events.**

- **What are business “meals”?**
 - **Example: food and beverage costs for meals with customers or prospective customers that has business purpose.**
 - **If no business is discussed, its not deductible.**

Opportunity Zones

- Each state permitted to select and propose for certification 25% of its LICs.
- Ohio has certified OZs in 73 counties
- 2 census tracts in Lake County are OZ:
 - Fairport Harbor east of Grand River
 - Portion of Painesville east of Lake Erie College

Tax Incentive for Opportunity Zone Investment

- Roll-over gain from sale of appreciated asset
- Gain reinvested in OZ fund within 180 days
- Gain deferred until earlier of 2026 or date investment sold
- If investment held for 10 years, gain on appreciation excluded from tax.

Opportunity Zone Fund Requirements

- Treasury may require an OZ fund to be certified – guidance will be forthcoming.
- 90% of OZ assets must be OZ property
 - Purchased after 12/31/17
 - New or substantially improved by fund
 - Located in an OZ and used in a business
- An OZ may also invest in business entities that purchase business property in an OZ on or after 12/31/17 and meet other requirements.



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Experience and Background

- Specializes in S-corporation, partnership and real estate taxation
- Represents a wide variety of corporate clients, family-owned businesses, and entrepreneurs.
- Typically engaged for sales and purchases of businesses, business succession planning, private equity investment and estate planning, and tax matters and disputes.
- IRS examinations, appeals and litigation
- Ohio Super Lawyer for 2008 through 2018
- Former IRS Chief Counsel Attorney
- **Memberships & Associations**
- American Bar Association
- Geauga Growth Partnership, Mentor and Western Lake County Chambers of Commerce.